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Brief Submission to the

PARLIAMENTARY TASK FORCE
ON FEDERAL-PROVINCIAL FISCAL ARRANGEMENTS

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by

the Social Planning Council
of Metropolitan Toronto

April 30, 1981

Price: $2.00

CONCLUSIONS AND RECOMMENDATIONS

1. It is suggested herein that the present arrangements under which the federal government shares in the financing of Canada's major human service programs has meant a denial of the basic and historical tenets that underly the development of these human services. The federal government has become less able to assure economic stability. It has certainly become less flexible in the means it can use to guarantee stable incomes and full employment.

2. Recent developments in both health and post-secondary education programs lead to doubts with respect to the current commitment of Canadian governments to the quality of services provided and access to them. This is especially true in the case of health. The recent report, Canada's National-Provincial Health Program for the 1980's: A Commitment for Renewal, dubbed the Hall Report after its author, the Honourable Emmett M. Hall, C.C., Q.C., details the decline in universal accessibility to our health care system. The report of the Ontario Council on University Affairs, System on the Brink (1979), details tendencies in Ontario's post-secondary education system. These tendencies may be more prevalent in Ontario than in other provinces, but the tendencies are largely national in extent.

3. There is a need for the federal government to return to its previous commitment to full employment and the maintenance of adequate national standards in the delivery of human and social services. Full employment should remain the first principle of social security, as was emphasized almost forty years ago in the report on social security by L. Marsh.

4. There is little doubt that the federal government is paying a larger share of the costs of health and post-secondary education programs now than it did six years ago. There is insufficient recognition that this share is not much above that predicted when the existing arrangements were entered into or that this share is still little above 50 per cent. We can nevertheless understand why the federal government might be concerned with respect to its existing commitments.

5. They appear particularly onerous in light of the failure of the federal government to gain sufficient access to rapidly growing resource revenues and in light of provincial spending restraints. However, we do not think that the users of Canada's health care and post-secondary education system should suffer simply because the federal government has not yet found a way to gain access to a lucrative revenue source.

6. The federal government could both solve the dilemma of the open-ended financing arrangements and decline in service quality that has occurred with block-funding, if it returned to cost-sharing principles, which prevailed prior to 1977, and insisted that federal funds be spent on the programs for which they were intended. The federal government currently finances about half of Canada's health budgets if the programs included are defined more broadly than before 1977, as noted in paragraph 10 below. A new cost-sharing formula for establishing future federal transfers should incorporate the broader definition of health spending. The advantage for the federal government of a return to shared cost funding would be that its future contributions to the established programs would be only 50 per cent of provincial spending increments, rather than the 70 or 80 per cent over the past five years. The federal funding formula we are proposing would incorporate the 13.5 tax points transferred to the provinces in 1977.

7. We foresee several positive results from the implementation of the above principles. Firstly, federal funding would be tied to provincial budgetary spending on the established programs rather than to tax collections or growth in the gross national product. Secondly, the incentive to reduce the quality of human service programs, which has existed under block funding, would be lessened. A provincial government would receive a dollar for the established programs only if it spent a dollar. The proposed principles would allow the federal government to reduce its fiscal transfers to provinces like Ontario that had been practising unusually stringent spending controls.

8. There is considerable disagreement amongst economists as to whether the present magnitude of the federal budgetary deficit is harmful. Some argue that a deficit is appropriate at a time of slow economic growth.

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8. There is considerable disagreement amongst economists as to whether the present magnitude of the federal budgetary deficit is harmful. Some argue that a deficit is appropriate at a time of slow economic growth.

Others argue that the present deficit is inflationary. To the extent that the deficit is harmful, the federal government, we recognize, would still be left the issue of how to cover it. We argue below that this issue can be totally separated from that of established programs financing. There are many ways to raise additional revenues. The federal government can reduce growing tax expenditures. It can increase tax levels. If such measures are required they should be confronted directly. We strongly object to the proposal to further sacrifice Canada's human service programs to solve the growing budgetary dilemma of either level of government.

BACKGROUND TO CURRENT FEDERAL-PROVINCIAL FISCAL RELATIONS

1. The current mix of tax-sharing arrangements, shared cost programs, equalization payments and revenue guarantees which constitute the subject under investigation by this Parliamentary task force is the product of a variety of complex and interdependent factors. Any attempt to radically revise existing arrangements and, more importantly, any attempt to drastically reduce the fiscal commitments of the federal government must carefully consider the circumstances which initially gave rise to them: 1) the widespread perception that emerged during the 1930's of the need for a comprehensive system of social security that could protect all Canadians against economic and social hardship; 2) the commitment made by the federal government at the end of World War II to make full use of fiscal and other economic policies to maintain high and stable levels of employment and income throughout the Canadian economy; and finally, 3) the constitutional distribution of power between the federal and provincial governments which assigned both federal and provincial levels shared access to direct taxation and the provincial level the delivery of most social programs.

2. In the eyes of those who formulated these policies in the years during and following World War II, the kinds of demands made upon governments to assume responsibility for the overall stability and levels of performance of the economy, combined with the constitutional structure of the Canadian state, made it virtually impossible for any one level of government to assume the exclusive responsibility to oversee the social and economic welfare of all Canadians. The particular mix of policies which eventually emerged was the product of many years of continuous debate and study on the part of many participants at both levels of government.

3. The first major design for the postwar fiscal and social security regime was advanced in the Report of the Royal Commission on Dominion-Provincial Relations in 1940. Underlying the analysis and recommendations of its report were two themes: 1) that each level of government needed to be guaranteed the fiscal resources adequate to ensure that they could effectively carry out their constitutionally assigned legislative responsibilities; and 2) that the recognition and preservation of provincial

particularisms within the Canadian federation necessitated a clear distinction between the legislative responsibilities of the two levels of government. In an attempt to implement these principles, the Commission proposed that welfare responsibilities for unemployment insurance and old age pensions be transferred exclusively to the federal government, that responsibility over the remaining areas of welfare, health and education remain vested solely in the hands of the provinces, that the federal government be assigned exclusive control over the fields of direct taxation in order to allow it full scope for the fulfillment of its responsibility for the integration of the national economy, and that it in turn make annual national adjustment grants to the provinces to ensure them a level of fiscal resources adequate for the fulfillment of their responsibilities. The provincial governments rejected these proposals.

4. Another important impetus towards the development of the postwar fiscal and social security system was the Report on Social Security prepared by Leonard Marsh for the Advisory Committee on Reconstruction in 1943. The Marsh Report outlined a comprehensive plan for improved social insurance. The first part of his system consisted of an insurance scheme for wage earners to protect against income loss through unemployment, sickness, disability, death and maternity, which would be administered except for workmen's compensation, by the federal government. The second part of his insurance system called for benefits for all gainfully occupied persons to cover old age retirement, permanent disability, death of insured persons and funerals, which would also be administered by the federal government. He called for a separate family allowance scheme, as well as a comprehensive system of health insurance, a government administered program of public works projects and a federally sponsored system of training and placement facilities. Marsh's social security proposals were directly rooted within the intellectual configuration of Keynesian economic ideas which were beginning to pervade government circles during the war years. He justified the direct government expenditures on public works, as well as the comprehensive system of social insurance, in terms of the contribution which they would make to high levels of aggregate demand, and consequently to stable levels of employment and income.

5. The federal government proceeded during the final years of World War II to draft a comprehensive program for the overhaul of federal-provincial relations which would guarantee the federal government the powers it required to implement Keynesian full employment policies and put in place an improved social security and health insurance system. The final product of this lengthy process was the Proposals of the Government of Canada to the Dominion-Provincial Conference on Reconstruction, popularly known as the Green Book, in 1945. The Green Book proposals called for the following changes: 1) the provinces would forego the levying of personal and corporate income taxes, as they had done during the years of the war, and would receive in return annual unconditional subsidies from the federal government; 2) the federal government would share with the provinces the costs of a comprehensive health insurance plan and provide financial assistance to the provinces in the form of specific health grants and in the subsidization of hospital construction; 3) the federal government would assume exclusive responsibility for old age pensions, for providing assistance for those not covered by unemployment insurance; and 4) the federal government would cooperate with the provinces in the field of natural resource conservation and public investment projects. As had been the case in 1941, these were rejected by the provincial premiers on the grounds that they violated crucial principles of provincial autonomy. While the provinces rejected the federal proposals in the series of meetings held between August 1945 and May 1946, this package eventually constituted the basis of the system of shared cost programs and tax rental/sharing agreements that were gradually implemented over the next two decades.

THE KEYNESIAN CONTEXT FOR UNDERLYING EXISTING FEDERAL-PROVINCIAL FISCAL RELATIONS

6. There was a unique combination of factors which made the federal proposals to the conference on reconstruction ultimately the most attractive. The device of the tax rental agreement, first employed during the war, allowed both levels of government to retain their constitutional rights to the key sources of direct taxation untouched. At the same time, however, the federal government's argument that it needed major control over these

key levers of taxation to implement fiscal policies in a way that would contribute to the stabilization of employment and income levels was eventually accepted by all the provinces. The principle that the federal government should also use its access to the direct taxes in order to equalize income levels across all the provinces was also accepted as an important principle in the postwar federal system. The combination of tax rental/sharing agreements, first negotiated in 1947, was the product of a lengthy process of policy evolution and federal-provincial compromise. The great strengths of the system that was implemented was the flexibility which it allowed both levels of government. It provided the federal government with the control which it felt it needed over the major levers of fiscal policy, while guaranteeing the provinces the level of revenues which they both felt that they were entitled to and that they needed in order to carry out the constitutional responsibilities assigned to them.

7. The same principles of flexibility and adaptation underlay the negotiation of a complex series of shared cost programs, commencing with the first national health grants in 1949 and extending through to Medicare in 1968. Joint federal and provincial funding of these programs assured the federal government that adequate and consistent national standards could be maintained. The provinces retained administrative control over policies which lay within their exclusive constitutional jurisdiction. Once again the link between the shared cost programs and Keynesian fiscal ideas cannot be overlooked. The constitutional justification for the federal government's involvement in these programs was its unlimited spending power. The political justification for many of the shared cost programs, particularly in the social policy field, was the contribution that social insurance programs made to the maintenance of high levels of aggregate demand, especially in periods of economic decline, and consequently to the stabilization of overall levels of economic activity. Throughout the buoyant and expansionary economic period until the early 1970's this justification for federal involvement in the shared cost programs remained unchallenged.

8. Although the provincial government's have traditionally complained about the federal government's use of its unlimited spending power to influence priorities, it was the federal government which first raised the

question seriously of its withdrawal from these fields in its June 1975 Budget. The federal government announced that it was placing arbitrary ceilings on its contributions to the Medicare Act and that it intended to terminate the Hospital Insurance Agreements in 1980, the earliest possible date. The motivation for the federal government's unilateral action was apparently twofold: on the one hand, it was concerned over the open-ended nature of its contributions to these programs and its growing inability to control the rate of growth of a major portion of its budgetary expenditures; on the other hand, it was concerned over the different amounts that were being spent on these various programs in the various provinces. As the problems of maintaining low levels of unemployment and stable levels of price increases intensified during the mid-1970's, it became more susceptible to arguments that government deficits were a major contributor to inflation and that the assumptions of Keynesianism were no longer valid. The unilateral federal initiative of 1975 led ultimately through the complex negotiation process of 1976 to the current Fiscal Arrangements and Established Programs Financing Act of 1977.

THE FEDERAL-PROVINCIAL FISCAL ARRANGEMENTS AND ESTABLISHED PROGRAMS FINANCING ACT, 1977

9. The Fiscal Arrangements and Established Programs Finacing Act, 1977, applies principally to joint federal-provincial financing of health insurance and post-secondary education programs. It also applies to the fiscal equalization payments to the poorer provinces. The 1977 Act does not apply to federal-provincial cost-sharing on a 50-50 basis of the Canada Assistance Plan, under which social assistance and social welfare services are financed. It will be discussed separately. The Fiscal Arrangements and Established Programs Financing Act, 1977, provided for the transfer of 13.5 income tax points from the federal to the provincial governments, as well as for cash transfers to the provinces on an equalized per capita basis and indexed to nominal growth in Canada's gross national product. The Act also contains revenue guarantees with respect to the tax points.

10. A significant increase in the federal share of EPF programs has occurred since 1976/77. As can be seen in Table 1, the resulting federal

Table 1

PROVINCIAL USES OF ESTABLISHED PROGRAM FUNDING

(Health Spending Defined Under the Hospital and Diagnostic Services Act and by the Medicare Act)

Total Expenditure on Health and Post-Secondary Education and Contributions

($ Millions)

	1975-76	1976-77	1977-78	1978-79	1979-80
Provincial Expenditures on insured health services and Total Operating Expenditures of Post Secondary Education	11,720.2	13,284.9	14,157.5	15,594.3	17,073.3
% Growth		13.35%	6.57%	10.15%	9.48%
Federal Contribution (Dec. 1979 Estimates)	5,069.3	5,867.6	7,085.6	8,103.2	9,189.7
% Growth		15.75%	20.76%	14.36%	13.41%
Health Insurance Premiums, Fees and Other Private Contributions and Municipal Contributions	1,244.7	1,561.3	1,698.2	1,908.1	2,014.6
Provincial Contribution	5,406.2	5,856.0	5,373.7	5,583.0	5,869.0

Funding Shares

	1975-76 %	1976-77 %	1977-78 %	1978-79 %	1979-80 %
Federal Share	43.25	44.17	50.05	51.96	53.82
Private Premiums and Municipal Share	10.62	11.75	12.00	12.24	11.80
Provincial Share	46.13	44.08	37.96	35.80	34.38

Source: Canada, Ministry of State for Social Development.

share of the established programs increased from 44.2 per cent in 1976 - 1977, the year immediately prior to the implementation of the Act, to 53.8 per cent in 1979/80. The federal government has in fact contributed nearly 88 per cent of all increased costs of the Established Programs since 1976/77. It is important to qualify this conclusion in two ways. First, the federal contribution is still not much above the 50 per cent which has traditionally governed federal contributions to shared-cost programs. Secondly, two-thirds of the growth in the federal contribution occurred in the year immediately following the implementation of the 1977 Act. This part of the increase was certainly anticipated. As is shown in Table 2 the federal share was barely over 50 per cent if health and post-secondary education expenditures by the provinces are defined more broadly, that is, if health expenditures are defined more broadly than formerly under the Medicare Act and Hospital and Diagnostic Services Act.

11. The above picture is altered appreciably in the particular case of Ontario. The federal share of EPF programs in Ontario increased from 49.6 per cent in 1976/77 to 52.8 per cent in 1977/78. As can be seen in Table 3, it subsequently increased to 62.1 per cent in 1980/81, the most recent year for which expenditure estimates are available. Ontario has applied much more spending restraint than have most other provinces. The result is that taxpayers in the rest of Canada are subsidizing an increasing proportion of expenditures in Ontario. From 1976/77 to 1979/80 Ontario substituted 95 per cent of increased federal entitlements for provincial expenditures.

12. As can be seen in Tables 4 and 5, the federal share of both health and post-secondary education in Ontario has increased considerably, much more so in the case of post-secondary education than in the case of health.

13. Federal contributions to the established programs in Ontario, and especially the increase in contributions since 1977/78, present a dilemma for the federal and Ontario governments, as well as for the nation as a whole. Tax payers across Canada are paying for an increasing share of the established programs in Ontario. There are fewer hospital beds per capita. The number of doctors opting out of Medicare - charging a higher fee schedule than that

Table 2

PROVINCIAL USES OF ESTABLISHED PROGRAM FUNDING

(Health Spending Broadly Defined)

Total Expenditure on Health and Post-Secondary Education and Contributions

($ Millions)

	1975-76	1976-77	1977-78	1978-79	1979-80
Provincial Expenditures on All Health plus Operating Expenditures of Post Secondary Education	12,453.7	14,221.2	15,330.5	16,965.8	18,661.4
% Growth		14.19%	7.53%	10.94%	9.68%
Federal Contribution (Dec. 1979 Estimate)	5,156.2	5,967.7	7,261.8	8,266.1	9,352.6
% Growth		15.74%	21.68%	13.83%	13.24%
Health Insurance Premiums, Fees and Other Private Contributions and Municipal Contributions	1,244.7	1,561.3	1,698.2	1,908.1	2,014.6
Provincial Contribution	6,052.7	6,692.2	6,370.5	6,791.6	7,294.2

Funding Shares

	1975-76 %	1976-77 %	1977-78 %	1978-79 %	1979-80 %
Federal Share	41.40	41.96	47.37	48.72	50.12
Private Premiums and Municipal Share	10.00	10.98	11.08	11.25	10.80
Provincial Share	48.60	47.06	41.55	40.03	39.09

Source: Canada, Ministry of State for Social Development.

Table 3

COMPARISON OF GROWTH RATE IN E.P.F. FEDERAL TRANSFERS AND PROVINCIAL BUDGETARY EXPENDITURES ON HEALTH AND POST-SECONDARY EDUCATION, 1976 - 77 TO 1980 - 81

($ millions)

	1980 - 81	1979 - 80	1978 - 79	1977 - 78	1976 - 77	Compound Average Annual Growth Rate
Federal Transfers:						
Established Programs Financing						
Income Tax	1,345.0	1,184.2	1,087.9	965.6	-	
Cash Transfer	1,848.6	1,711.7	1,499.7	1,140.4	-	
Hospital Insurance	7.0	47.2	28.5	29.1	1,027.0	
Medicare	-	-	-	7.6	360.0	
Post-Secondary Education	-	-	-	-	611.9	
E.P.F. Revenue Guarantee	226.8	209.6	187.3	166.9	-	
TOTAL	3,427.4	3,152.7	2,803.4	2,309.6	1,998.9	14.4%
Province of Ontario:						
Total Budgetary Expenditure	15,146	13,934	12,900	12,073	11,031	8.2%
Health Budgetary Expenditure	4,717	4,269	3,955	3,631	3,349	8.6%
Insured Health Services	3,990	3,575	3,334	3,114	2,873	8.9%
Post-Secondary Education Budgetary Expenditure	1,526	1,439	1,372	1,257	1,158	7.1%
Sub-Total, Established Programs	5,516	5,014	4,706	4,371	4,031	8.2%
Federal Transfers as a Per Cent of Established Programs Spending	62.1	62.9	59.6	52.8	49.6	5.8%

Sources: Estimates (Ontario), 1980 - 81; Public Accounts (Ontario), 1976 - 77 to 1979 - 80; Ontario Budget, 1980; Fiscal Policy Division, Ministry of Treasury and Economics.

Table 4

HEALTH SERVICES SPENDING AND SOURCES OF REVENUES (ONTARIO), 1972 - 73 TO 1980 - 81

($ millions)

(Estimates)	Actual Expenditures							
1980 - 81	1979 - 80	1978 - 79	1977 - 78	1976 - 77	1975 - 76	1974 - 75	1973 - 74	1972 - 73
3,989.5	3,574.9	3,333.9	3,113.5	2,872.9	2,462.8	2,113.5	1,737.6	1,634.9
2,382.8	2,161.0	2,054.2	1,989.2	1,881.1	1,600.7	1,400.3	1,105.0	1,034.3
163.4	148.1	132.0	120.2	101.9	86.8	63.3	47.7	30.7
1,443.3	1,265.8	1,147.7	1,004.1	889.9	775.3	658.4	584.9	569.9
727.2	694.5	621.1	517.2	475.9	523.1	423.9	316.9	257.5
15.4	16.3	15.7	14.2	14.2	17.5	16.7	18.2	13.6
4,716.7	4,269.4	3,955.0	3,630.7	3,348.8	2,985.9	2,537.4	2,054.5	1,892.4
1,054.0	1,036.9	977.2	829.9	798.7	572.5	548.1	530.1	519.9
26.4	29.0	29.3	26.6	27.8	23.2	25.9	30.5	31.8
7.0	47.2	28.5	29.1	1,027.0	848.6	651.9	533.2	475.3
-	-	-	7.6	360.0	287.7	275.2	243.3	209.8
915.9	806.4	740.9	657.6	-	-	-	-	-
1,258.9	1,165.7	1,021.3	776.6	-	-	-	-	-
154.5	142.7	127.6	113.7	-	-	-	-	-
2,336.3	2,162.0	1,918.3	1,584.6	1,387.0	1,136.3	927.1	776.5	685.1
58.6	60.5	57.5	50.9	48.3	46.1	43.9	44.7	41.9
49.5	50.6	48.5	43.6	41.4	38.0	36.5	37.8	36.2
599.2	376.0	438.4	699.0	687.2	754.0	638.3	431.0	429.9
15.0	10.5	13.1	22.5	23.9	30.6	30.2	24.8	26.3

ntario), 1972 - 73 to 1979 - 80; Ontario Budget 1980; Fiscal Policy Division, Ministry

Table 5

POST-SECONDARY EDUCATION EXPENDITURES AND SOURCES OF FUNDING (ONTARIO), 1972 - 73 TO 1980 - 81

($ millions)

	Estimated	Actual Expenditures							
	1980 - 81	1979 - 80	1978 - 79	1977 - 78	1976 - 77	1975 - 76	1974 - 75	1973 - 74	1972 - 73
Ministry of Colleges and Universities:									
University Support	943.0	893.1	855.8	797.3	741.6	655.3	573.6	506.3	467.4
College and Adult Education Support	487.9	454.8	427.5	385.6	354.3	309.1	260.6	242.3	211.0
Other	95.2	90.9	88.6	74.5	61.7	54.7	44.2	35.8	28.0
TOTAL BUDGETARY EXPENDITURE	1,526.1	1,438.8	1,371.9	1,257.4	1,157.6	1,019.1	878.4	784.4	706.4
Tuition Fees - Universities	161.0	147.3[e]	138.1[e]	137.4[e]	119.1	117.6	101.6	95.8	85.8
Community Colleges	50.0	46.4[e]	42.4[e]	38.7[e]	30.5	28.4	24.3	21.4	16.1
TOTAL	211.0	193.7	180.5	176.1	149.6	146.0	125.9	117.2	101.9
Federal Contributions:									
Tax Points/Revenue Guarantee	459.3	414.2	372.8	355.3	422.0	366.0	296.2	247.8	209.8
Cash Transfer	631.8	572.5	497.1	405.2	189.9	164.5	142.7	153.6	161.7
Adult Occupational Training Agreement	104.0	88.0	104.6	76.1	79.7	71.4	60.1	65.5	66.0
TOTAL FEDERAL SPENDING	1,195.1	1,074.7	974.5	836.6	691.6	601.9	499.0	466.9	437.5
As a Percentage of M.C.U. Expenditure	78.3	74.7	71.0	66.5	59.7	59.1	56.8	59.5	61.9
TOTAL PROVINCIAL SPENDING	120.0	170.4	216.9	244.7	316.4	271.2	253.5	200.3	167.0
As a Percentage of M.C.U. Expenditure	7.9	11.8	15.8	19.5	27.3	26.6	28.9	25.5	23.6

Sources: Department of the Secretary of State (Canada), Annual Reports, 1972 - 73 to 1979 - 80; Preliminary Report of the Committee on the Future Role of Universities in Ontario, March 1981 (Background Data); Ontario Council on University Affairs, Sixth Annual Report 1979 - 80; Estimates (Ontario) 1980 - 81; Public Accounts (Ontario) 1972 - 73 to 1979 - 80; Fiscal Policy Division, Ministry of Treasury and Economics (Ontario).

e - Estimates based on audited statements, multi year plan analysis, College Affairs Branch, Ministry of Colleges and Universities.

reimbursed by the provincial government - has doubled in the past couple of years. Real per capita post-secondary operating expenditures declined by 6 per cent in Ontario, while they increased by about the same amount for the rest of the nation.

14. Table 6 shows a comparison of established program financing in Ontario with the rest of Canada. From 1975/76 to 1979/80 total spending for established programs increased by about 38 per cent in Ontario and by over 50 per cent in the rest of Canada. In 1979/80 federal contributions were nearly 56 per cent in Ontario and nearly 53 per cent in the rest of Canada. User fees and municipal contributions increased in Ontario from nearly 19 per cent of the total to nearly 23 per cent from 1975/76 to 1979/80. User fees in the rest of Canada remained constant at around six per cent of total program costs. From 1975/76 to 1979/80 provincial contributions increased by over 23 per cent, while they declined by a similar amount in Ontario.

15. The solution to the dilemma, as we see it, is to find a formula for financing the established programs that is faithful to the historic principles described above, but which does not result in national tax payers subsidizing an increasing share of program costs in Ontario or Manitoba or in any other province that might implement similar spending restraints on human services.

FEDERAL-PROVINCIAL FISCAL RELATIONS, BUDGETARY RESTRAINT AND FEDERAL ECONOMIC POLICIES

16. It is critical to note that the federal government's abandonment of the regime of tax sharing arrangements and shared cost programs came at exactly the same point that it was abandoning Keynesian countercyclical budgetary principles in favour of the incomes policy outlined in the Anti-Inflation Act, 1975, and the Bank of Canada's adoption of a strategy of gradualism to control inflation through limiting the rate of growth of the money supply. In the six years since the federal government announced its intention of altering the basis of the federal-provincial tax sharing arrangements and shared costs programs, several observations can be made. In the

Table 6

ESTABLISHED PROGRAM FINANCING
IN ONTARIO AND THE REST OF CANADA

		ONTARIO	As a Per Cent of Total	REST OF CANADA	As a Per Cent of Total	CANADA	As a Per Cent of Total
Health and	1975 - 76	4,301.5	100.0	7,418.7	100.0	11,720.2	100.0
Post Secondary	1976 - 77	4,885.1	100.0	8,399.8	100.0	13,284.9	100.0
Education	1977 - 78	5,240.0	100.0	8,917.5	100.0	14,157.5	100.0
Operating	1978 - 79	5,603.7	100.0	9,990.6	100.0	15,594.3	100.0
Expenditures	1979 - 80	5,925.3	100.0	11,148.0	100.0	17,073.3	100.0
Per Cent Change	1975 - 76 to 1979 - 80	37.7		50.3		45.7	
Federal Contributions	1975 - 76	1,827.3	42.5	3,242.0	43.7	5,069.3	43.3
	1976 - 77	2,080.1	42.6	3,787.5	45.1	5,867.6	44.2
	1977 - 78	2,554.4	48.7	4,531.2	50.8	7,085.6	50.0
	1978 - 79	2,924.4	52.2	5,178.8	51.8	8,103.2	52.0
	1979 - 80	3,306.4	55.8	5,883.3	52.8	9,189.7	53.8
Per Cent Change	1975 - 76 to 1979 - 80	80.9		81.5		81.3	
Health Insurance	1975 - 76	799.4	18.6	445.3	6.0	1,244.7	10.6
Tuition,	1976 - 77	1,047.9	21.5	513.4	6.1	1,561.3	11.8
User Fees,	1977 - 78	1,103.0	21.0	595.2	6.7	1,698.2	12.0
etc.	1978 - 79	1,270.3	22.7	637.8	6.4	1,908.1	12.2
	1979 - 80	1,343.8	22.7	670.8	6.0	2,014.6	11.8
Per Cent Change	1975 - 76 to 1979 - 80	68.1		50.6		61.9	
Provincial Contributions	1975 - 76	1,671.9	38.9	3,734.3	50.3	5,406.2	46.1
	1976 - 77	1,754.0	35.9	4,102.0	48.8	5,856.0	44.1
	1977 - 78	1,578.7	30.1	3,795.0	42.6	5,373.7	38.0
	1978 - 79	1,404.6	25.1	4,178.4	41.8	5,583.0	35.8
	1979 - 80	1,271.4	21.5	4,597.6	41.2	5,869.0	34.4
Per Cent Change	1975 - 76 to 1979 - 80	-(24.0)		23.1		8.6	

Source: Canada, Ministry of State for Social Development.

first place, the federal government's deficit has increased from $1,650 million in 1975 to $11,375 million in 1980. In the period from 1975 to 1979 federal government deficits increased from $3,805 million to $9,169 million on a national accounts basis. The provincial government budgetary balance shifted in the same period from a deficit of $1,756 million to a surplus of $553 million (on a national accounts basis). Substantial evidence suggests that prime causes of the growing federal deficit in this period have been the oil import compensation payments made to the eastern provinces as well as the rapidly expanding volume of tax expenditures to corporations and individuals made through the proliferating volume of tax exemptions.

17. In the latter context it is worth noting that the real rate of corporate income tax declined from 38 per cent in 1971 to under 30 per cent in 1979 and that income taxes declined by 17 per cent relative to total income from 1972 to 1978. The re-establishment of early 1970's tax rates for both corporate and personal income taxes would result in the realization of an additional $7 billion in revenues in 1980. Given the fact that federal contributions to the established programs under the block funding formula has increased more rapidly than the rate of growth of GNP, it is even possible that the transfer of an additional 13.5 points of personal income tax to the provinces under the 1977 arrangements has cost it more in revenues than the termination of the shared cost financing arrangements has saved it in expenditures.

18. In the same period, the annual rate of inflation has risen to even higher levels than those which prompted the government to introduce the Anti-Inflation Program in October 1975. Finally, a growing body of evidence suggests that neither the Anti-Inflation Program nor the Bank of Canada's strategy of gradualism are likely to have a significant impact on the future rate of inflation. A recently published study by the Conference Board in Canada has suggested that the Canadian economy is exceptionally vulnerable to inflation generated from external sources:

> More than 40 per cent of the inflation in Canada during the 1970's originated outside the country. The important role played by international prices makes the achievement, through the use of stabilization policy, of a rate of price increase in Canada which is significantly lower than in the rest of the world exceedingly difficult.*

Other studies, such as those published by the Canadian Institute for Economic Policy, have argued that the appropriate instruments to deal with the international transmission of inflation is exchange rate adjustments rather than restrictive fiscal and monetary policies which ultimately lower the rate of economic growth, reduce the rate of expansion of the revenue base and impose even greater restraints on the scope of government spending.**

19. The question raised by these facts is whether the quality, standards and comparability of several of the established programs has been sacrificed on the false alter of government spending restraint and lowering the rate of inflation. If in fact, as this submission has argued, the federal government's commitment to improved social security, health care and education programs has been integrally tied to the Keynesian economic goal of high and stable levels of employment and income, and if as was argued, the abandonment of the shared cost format for funding these programs was tied to the abandonment of these goals in the mid-1970's, perhaps the federal government should most appropriately examine whether the initial assumption about the viability of Keynesian economic policies was incorrect, before it proceeds to dismantle the remainder of the health care and post-secondary education programs, as the Minister of Finance suggested in the October 1980 budget.

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*Reginald S. Letourneau, Inflation: The Canadian Experience (Ottawa: The Conference Board in Canada, 1980), p.78.

**Clarence L. Barber and John C. P. McCallum, Unemployment and Inflation: The Canadian Experience (Toronto: J. Lorimer and Co., 1980), Chapter 6.

THE CANADA ASSISTANCE PLAN

20. The Canada Assistance Plan as we know it today was passed by Parliament in 1966. For the most part it replaced previous categorical programs also subject to cost-sharing. It provides for 50-50 federal-provincial cost-sharing of a variety of income maintenance and social service programs. As in the case of the insured health and post-secondary education programs the federal government has evidenced some concern over the existing arrangement. Of primary concern has been the open-ended nature of the social service component of the Canada Assistance Plan. Generally, social services provided to those determined to be in need or likely to come into need are eligible for cost-sharing.

21. The federal government has recently made two aborted attempts to replace the present arrangements. Bill C-57 (1977) would have established a separate shared-cost regime for social services. It was later withdrawn due to opposition from Manitoba, Ontario and Quebec. It was replaced by Bill C-55 (1978) which provided for block-funding of social services. The Minister of Finance announced in August 1978 that this latter bill was being shelved for at least a year or two as part of an over-all spending restraint program announced at that time. That measure would have provided for enriched federal cost-sharing of social service programs. While it would have cost the federal government more than the present arrangements in the short-term, the advantage to the federal government would have been the imposition of long-term funding limitations. The growth rate in federal transfers to the provinces for social service spending was to be established in a predetermined schedule. The provinces agreed to the proposed new legislation because it would have provided enrichment monies for new and expanded social services and because it would have removed the federal government from its involvement in administering and approving cost-sharing of individual social service programs.

22. There is no doubt that there has been a tendency for many provincial governments to increase spending on social services at a faster rate than over-all budgetary spending. The termination of cost-sharing arrangements with respect to insured health and post-secondary education

programs adds further impetus to this tendency. At the same time, many provinces have been imposing tight spending restraints on income maintenance programs. Ontario's spending restraints on income maintenance are apparently amongst the most stringent.

23. Given the above, it would not be surprising to discover that the federal government was considering withdrawing from, or limiting, the sharing of costs for social services as part of its current fiscal restraint thrust. It is possible that the federal government might attempt to implement variable matched funding for the main components of the Canada Assistance Plan, one rate for income maintenance programs, presumably the current 50 per cent, and a lower rate, perhaps as low as 25 per cent, for social service programs. It is also possible that the federal government might want to eliminate shared-cost funding of particular social services, say, day care.

24. Neither the existing cost-sharing formula governing Canada Assistance Plan spending nor proposals to reduce the federal cost-sharing contribution to social services sufficiently recognize the complementarity of social services and other human services, including health. To reduce the federal share of social services funding would provide an incentive for provincial governments to disinvest in social services in general or in particular social services. Services would undoubtedly be curtailed. Additional user charges might be put in place. Those suffering would include the elderly, social assistance recipients, dependent children, and the handicapped. An important principle worth emphasizing with respect to the future funding of social services is that there should be complementarity in the funding of social services under the Canada Assistance Plan and other human services. It is also important to begin to develop a national consensus around the provision of social services parallel to that which now exists for health and post-secondary education. The federal government must contribute to developing this consensus. This consensus should likewise not be sacrificed on the altar of fiscal restraint.